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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, A. D. 1947.

No. 395

STIMSON MILL COMPANY,

*Petitioner.*

vs.

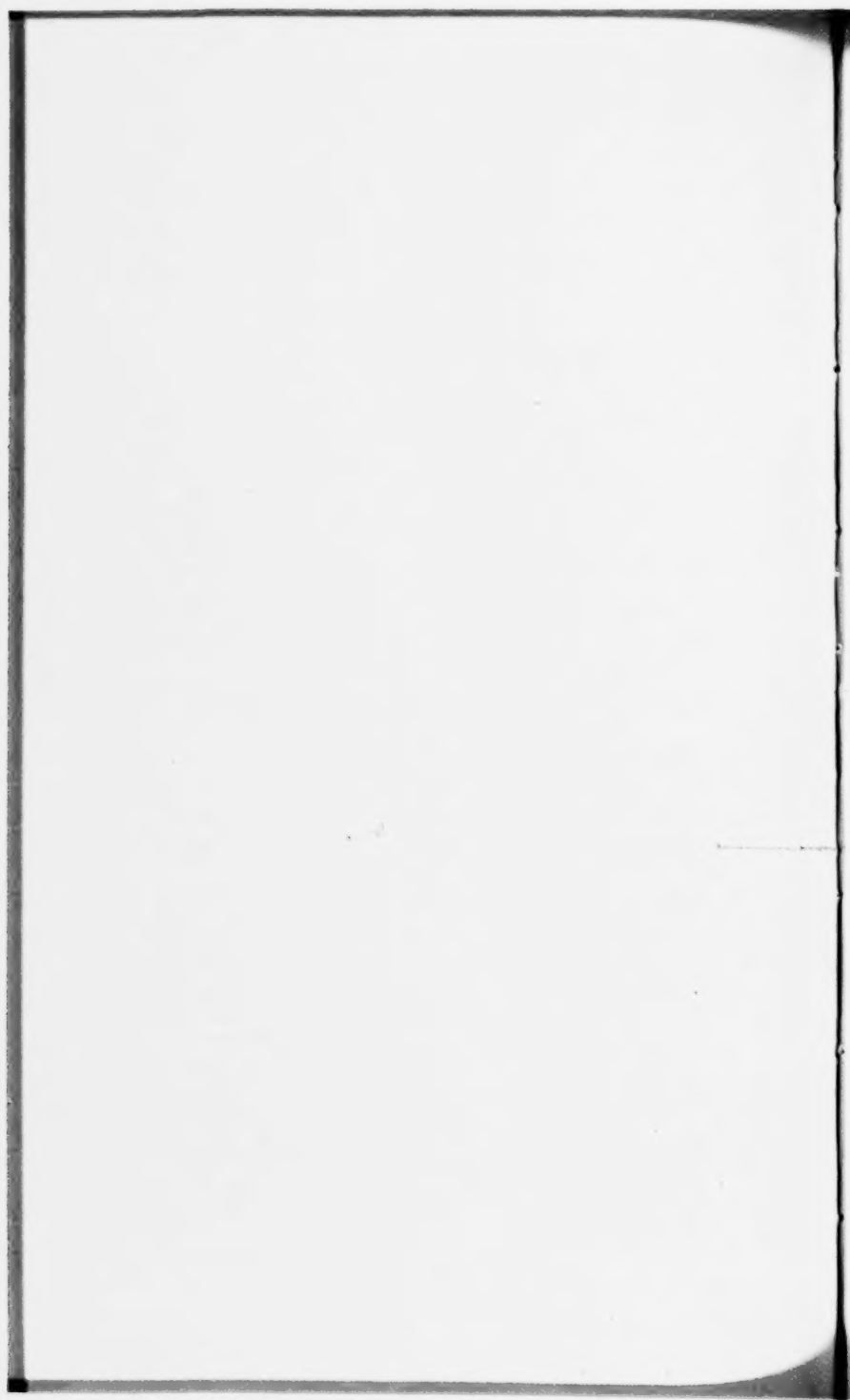
COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

**PETITION FOR WRIT OF CERTIORARI**  
**To the United States Circuit Court of Appeals**  
**For the Ninth Circuit**  
**And Brief In Support Thereof.**

BERT L. KLOOSTER,  
Attorney for Petitioner.

CHAPMAN and CUTLER,  
Of Counsel.



## SUBJECT INDEX

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	PAGE
Petition for writ of certiorari .....	1
I Summary statement of matter involved .....	2
II Statement particularly disclosing basis of jurisdiction .....	7
III The questions presented .....	8
IV Reasons for allowance of the writ .....	11
Prayer for writ .....	14
Brief in support of petition for writ of certiorari.....	15
Opinions of courts below .....	15
Jurisdiction .....	15
Statement of the case .....	16
Specification of errors .....	16
Summary of argument .....	16
Argument .....	17
A. Discretionary power of the Commissioner to de- termine "normal earnings" does not extend to prescribing rules for the computation of a con- structive average base period net income differ- ing from the applicable statutory definition.....	17
B. Provisions in the 1941 Act parallel to those in the 1942 Act require that the constructive aver- age be computed in the manner provided by sec- tion 713, and such provisions were not changed in substance or effect by changes in language in the 1942 Act .....	20
C. Although Stimson's tax admittedly is excessive and discriminatory and although full proof has been made entitling Stimson to relief, neverthe- less relief has been denied in disregard of prin- ciples of statutory construction laid down and applied by this Court in other cases .....	23

	PAGES
Appendix .....	27
Excerpts from Sections 712 and 713 .....	27
Excerpts from Section 722 .....	30
Excerpts from Section 722 (1941 Act) .....	32
Excerpts from Regulations 112, Section 35.722-2(b)....	34

TABLE OF AUTHORITIES CITED IN BRIEF

CASES CITED IN BRIEF

<i>Addison v. Holly Hill Fruit Products</i> , 1944, 322 U. S. 607, 616, 618, 68 L. ed. 1488, 1495, 1496 .....	20
<i>Bomwit Teller &amp; Co. v. United States</i> , 1931, 283 U. S. 258, 263, 75 L. ed. 1018, 1021 .....	25
<i>Botany Worsted Mills v. United States</i> , 1928, 278 U. S. 282, 289, 73 L. ed. 379, 385 .....	19
<i>Bowles v. Willingham</i> , 1944, 321 U. S. 503, 515, 88 L. ed. 892, 903, 904 .....	19
<i>Harrison v. Northern Trust Co.</i> , 1943, 317 U. S. 476, 479, 87 L. ed., 407, 410 .....	22
<i>United States v. Ogilvie Hardware Co.</i> , April 7, 1947, ..... U. S. ...., 47-1 U.S.T.C. paragraph 9209....	25

STATUTES CITED IN BRIEF

Internal Revenue Code:	
Sec. 712 (26 U.S.C.A. 1945 ed. Sec. 712) .....	27
Sec. 713 (26 U.S.C.A. 1945 ed. Sec. 713) .....	2, 8, 10, 16, 17, 20, 22, 25, 27
Sec. 713(d) (26 U.S.C.A. 1945 ed. Sec. 713(d)) .....	6, 21, 28
Sec. 713(e) — Deficit Rule — Sec. 201, Second Revenue Act of 1940 (26 U.S.C.A. Internal Revenue Acts beginning 1940, p. 28) .....	21, 29

## (Statutes Cited in Brief — Continued)

	PAGES
Sec. 713(e) — 75% Rule — (26 U.S.C.A. 1945 ed. Sec. 713(e)) effective in 1942.....	3, 4, 5, 6, 8, 10, 11, 18, 21, 24, 28
Sec. 713(e) (1) (26 U.S.C.A. 1945 ed. Sec. 713(e) (1)) .....	9, 28
Sec. 713(f) (26 U.S.C.A. 1945 ed. Sec. 713(f))..	21, 29
Sec. 722 (26 U.S.C.A. 1945 ed. Sec. 722) effective in 1942 .....	2, 6, 8, 10, 11, 17, 21, 25, 30
Sec. 722 — 1941 Act — as enacted by Sec. 6, Excess Profits Tax Amendments of 1941 (26 U.S.C.A., Internal Revenue Acts Beginning 1940, pp. 83, 84) .....	21, 22, 32
Sec. 722(a) (26 U.S.C.A. 1945 ed. Sec. 722(a)) .....	10, 18, 24, 30
Sec. 722(a) — 1941 Act — (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 83) .....	22, 32
Sec. 722(b) (26 U.S.C.A. 1945 ed. Sec. 722(b)) .....	2, 10, 23, 24, 30
Sec. 722(b) (1) 26 U.S.C.A. 1945 ed. Sec. 722 (b) (1)) .....	18, 31
Sec. 722(b) (3) — 1941 Act — (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 84) .....	21, 33
Sec. 722(c) (26 U.S.C.A. 1945 ed. Sec. 722 (c)).....	10
Sec. 732(c) (26 U.S.C.A. 1945 ed. Sec. 732(c))....	7, 8
Judicial Code:	
Sec. 240(a) (28 U.S.C.A. Sec. 347(a)) .....	7
Revenue Act of 1941:	
Sec. 103, (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 102) .....	2
Revenue Act of 1942:	
Sec. 105(b) (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 172) .....	2
Sec. 202 (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 280) .....	2

## (Statutes Cited in Brief — Continued)

	PAGES
Sec. 215 (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 292) .....	29
Revenue Act of 1945:	
Sec. 122(a) (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 573) .....	27

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 MISCELLANEOUS CITATIONS IN BRIEF
 

---

A New English Dictionary on Historical Principles, J. A. H. Murray, Oxford, 1893 .....	17
Bouvier's Law Dictionary .....	17
Committee on Ways and Means, Report No. 2333.....	20
Mertens Law of Federal Income Taxation .....	18
Regulations 112:	
Sec. 35.722-2 .....	10
Sec. 35.722-2(b) .....	9, 17, 34
Webster's New International Dictionary, Second Edition .....	17

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STIMSON MILL COMPANY,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*  
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**PETITION FOR WRIT OF CERTIORARI  
To the United States Circuit Court of Appeals  
For the Ninth Circuit**  
\_\_\_\_\_

*To the Honorable Fred M. Vinson, Chief Justice of the  
United States, and the Associate Justices of the Supreme  
Court of the United States:*

The Petition of Stimson Mill Company (hereinafter  
called "Stimson") respectfully shows:

**I. Summary statement of the matter involved.**

In filing its excess profits tax return for the year 1942, Stimson computed its excess profits credit under section 713, such credit being 95% of "average base period net income" for the years 1936 to 1939, inclusive. Profits in excess of such credit were subjected to the excess profits tax at the rate of 90%. Profits covered by the amount of

the credit, however, were subject only to income tax and surtax at rates aggregating 40%.<sup>1</sup>

Stimson claimed that its "average base period net income" was an "inadequate standard of normal earnings" (section 722(b)) because its earnings for the year 1937 were abnormally low on account of a strike which occurred in that year, that its excess profits credit based thereon was also too low, and that as a result the excess profits tax was excessive and discriminatory, since too great a portion of the profits were subjected to the 90% excess profits tax, and too small a portion of the profits (represented by the said inadequate credit) were subject only to the 40% tax.

Stimson, therefore, filed an application for relief under section 722,<sup>2</sup> which provides for a determination of normal earnings for one or more years of the base period and for the use of such normal earnings in a "constructive average base period net income", which is used in lieu of "average base period net income" for computing the excess profits credit in section 713 by taking 95% of such "constructive average". The Commissioner denied the application on December 26, 1944 (R. 7), but after Stimson appealed to the Tax Court, he stipulated (R. 16, 17) that Stimson's

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<sup>1</sup> Normal tax at 24% was imposed by Sec. 103, Revenue Act of 1941, 26 U.S.C.A. Internal Rev. Acts beginning 1940, p. 102. Surtax at 16% was imposed by Sec. 105(b), Revenue Act of 1942, 26 U.S.C.A. Internal Rev. Acts beginning 1940, p. 172. Such rates of 24% and 16% aggregating 40% were here applied (Rec. 11).

Excess profits tax at 90% was imposed by Sec. 202, Revenue Act of 1942, 26 U.S.C.A. Internal Revenue Acts beginning 1940, p. 280. Such tax at 90% was here applied (Rec. 12).

Pertinent provisions of section 713 are set forth in the appendix. Other statutory adjustments in determining tax liability are not material to the question presented.

<sup>2</sup> Pertinent provisions of section 722 are set forth in the appendix.



“normal operation or output was interrupted in the year 1937 by strikes”, that because thereof “earnings for 1937 in the amount of \$63,706.57 were abnormally low” and that reconstructed earnings for that year amounted to \$85,263.34.

Nevertheless, the Commissioner denied relief by his method of computing the excess profits credit. He provided a computation for a “*constructive* average base period net income” which differed from the computation provided by the definition of “average base period net income” in section 713(e).

Before giving effect to relief provisions, Stimson’s “average base period net income” computed under section 713(e) (R. 16), compared with an ordinary average as follows:

Year	Ordinary Arithmetic Average	Standard of Normal Earnings Section 713(e)
1936	\$ 89,422.67	\$ 89,422.67
1937	63,706.57	63,706.57
1938	38,127.75	.....
1939	111,839.77	111,839.77
Aggregate	<u>\$303,096.76</u>	<u>\$264,969.01</u>
Average	<u><u>\$ 75,774.19</u></u>	<u><u>\$ 88,323.00</u></u>
Substitute 75% of 3-year average for 1938		\$ 66,242.25
Aggregate for 1936, 1937 and 1939 as above		<u>264,969.01</u>
Aggregate for four years		<u>\$331,211.26</u>
Average		<u><u>\$ 82,802.82</u></u>
Excess profits credit (95% of average)		<u><u>\$ 78,662.68</u></u>

As shown above, the computation of average base period net income under section 713(e) eliminates earnings for the lowest year from the "standard of normal earnings", and substitutes 75% of the earnings for the three higher years in their place. This computation of the statutory standard is sometimes called the "75% rule". The effect of Stimson's strike in 1937 was to cause the above standard of normal earnings to be inadequate because of two factors: (1) the figure used for 1937 earnings was too low; (2) the substituted figure for 1938 earnings (being based in part on such low 1937 earnings) was also too low.

The methods of computing the *constructive* average base period net income by use of the reconstructed figure for 1937, as claimed by the Commissioner and Stimson, respectively (R. 15, 16, 18, 19), compare as follows:

Year	Commissioner Ordinary Arithmetic Average	Stimson Constructive Standard of Normal Earnings
1936	\$ 89,422.67	\$ 89,422.67
1937 (reconstructed)	85,263.34	85,263.34
1938	38,127.75	.....
1939	111,839.77	111,839.77
Aggregate	<u>\$324,653.53</u>	<u>\$286,525.78</u>
Average	<u>\$ 81,163.38</u>	<u>\$ 95,508.59</u>
Substitute 75% of 3-year average for 1938		\$ 71,631.44
Aggregate for 1936, 1937 and 1939, as above		286,525.78
Aggregate for four years		<u>\$358,157.22</u>
Average		<u>\$ 89,539.31</u>
Excess profits credit (95%)	\$ <u>77,105.21</u>	<u>\$ 85,062.34</u>

Computing “constructive average base period net income” as Stimson contends in the manner prescribed by the definition in section 713(e), corrects the two abnormally low factors above mentioned, namely, (1) the low earnings for 1937, and (2) the low substituted figure for 1938 based in part on 1937 earnings. The result is a constructive statutory standard of \$89,539.31, (which approximately equals actual earnings for 1936) and an excess profits credit computed at 95% thereof amounting to \$85,062.34.

The Commissioner’s method of computing the “constructive average base period net income” as required by his regulations (see appendix) not only fails to correct the statutory factor for the year 1938, but uses \$38 127.75, a lower figure for that year, than the substituted figure of \$66,242.25 which the statute required to be used before “relief” was granted. According to the Commissioner the result is a “constructive average base period net income” of \$81,163.38, and an excess profits credit of 95% or \$77,105.21 (which is less than the “average” of \$82,802.82 and the credit of \$78,662.68, before “relief” was granted).

The Commissioner held that the average shall be the amount of \$82,802.82 computed under section 713(e) before “relief” was granted (R. 15, 16). The Court of Appeals and the Tax Court by their decisions herein have affirmed the action of the Commissioner.

Before the application of relief provisions the amount of tax paid by Stimson for the year 1942 (R. 11, 12) was as follows:

	Earnings	Tax Thereon	
	Year 1942	Rate	Amount
Subject to Income Tax	\$ 83,743.50	40%	\$ 33,497.40
Subject to Excess Profits Tax	279,298.24	90%	251,368.42
Total	<u>\$363,415.74</u>	78%	<u>\$284,865.82</u>

If Stimson's claims respecting the proper computation of the constructive average are sustained, the excess profits credit will be increased from \$78,662.68 to \$85,062.35 — an increase of \$6,399.67. The tax reduction (which would be subject to adjustment for the post-war credit) would be computed as follows:

	Difference in E. P. Credit	Tax Rate	Thereon Amount
Decrease in income subject to excess profits tax	\$6,399.67	90%	\$5,759.70
Increase in income subject to income tax	6,399.67	40%	2,559.87
Net reduction in total tax			<u>\$3,199.83</u>

Similar relief may also be applicable to petitioner's subsequent excess profits tax years not involved in this proceeding.

Although Stimson originally asked for greater relief than that given by the Commissioner's discretionary determination of normal earnings in the amount of \$85,263.34 for the year 1937, Stimson raises no question with respect to that determination.

The only issue is whether the Commissioner may require Stimson to use a constructive average base period net income not in accordance with the definition of "average base period net income" in section 713(d) and (e). Stimson's average base period net income computed without using reconstructed earnings for 1937 has been shown to be an inadequate standard of normal earnings and the statute deems the resulting excess profits tax to be excessive and discriminatory. Concededly, Stimson has borne the burden of establishing everything that was required to be established by section 722 in order to obtain relief. Concededly, if there had been no strike to reduce peti-

tioner's earnings below \$85,263.34 for the year 1937, the statute would have required the average to be computed at \$89,539.31 and the excess profits credit, at \$85,062.34. The issue, then, is whether the relief to which Stimson has proved it is entitled, may, nevertheless, be denied by the Commissioner's requirement that reconstructed normal earnings for one or more of the base period years may not be averaged in accordance with the standard that is concededly applicable in averaging normal earnings.

## **II. Statement particularly disclosing basis of jurisdiction.**

The jurisdiction of this Court is invoked under section 240(a) of the Judicial Code, 28 U.S.C.A. Sec. 347(a), providing "in any case, civil or criminal, in a Circuit Court of Appeals, . . . it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, . . . to require by certiorari . . . that the cause be certified to the Supreme Court . . ."

The date of the judgment of the Circuit Court of Appeals herein sought to be reviewed was July 21, 1947 (R. 81), and Stimson's petition for rehearing which was timely filed was denied on August 25, 1947 (R. 82).

Stimson avers that section 732(c) of the Internal Revenue Code (26 U.S.C.A. Sec. 732(c)), providing "If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of . . . section 722, the determination of such question shall not be reviewed or re-determined by any court or agency except the Board" (now the Tax Court), does not affect the jurisdiction of this Court for the following alternative reasons:

1. A determination respecting the computation of a constructive "average base period net income" involves

the construction of sections 713 and 722 and therefore is not the determination of a question necessary solely by reason of section 722. The Court of Appeals held (R. 70) that section 732(c) did not affect its jurisdiction because the determination of the question herein was necessary by reason of both sections.

2. Section 722 imposes a ministerial duty on the Commissioner to compute the "constructive average base period net income" as required by the statute, and the Commissioner has no discretionary power to "determine" whether to obey or disobey that duty, nor has he jurisdiction to make any "determination" relating thereto the review of which is precluded by section 732(c).

3. The Commissioner in prescribing rules for such constructive average, has attempted to make a "determination" which is beyond and outside of the statutory standards and provisions limiting the discretionary jurisdiction which Congress has conferred upon him, and such attempted "determination" is a nullity and does not constitute a determination the review of which is barred by section 732(c).

### **III. The questions presented.**

Question 1. Whether the jurisdiction of this Court to review the decision of the Court of Appeals is affected by section 732(c) (since this Court has the right and duty to determine its own jurisdiction).

Question 2. Whether the proper construction of the statute requires that "constructive average base period net income" be computed by using reconstructed normal earnings "in one or more taxable years in the base period" in the manner provided in section 713(e) as though such

earnings were the "excess profits net income" for the year or years for which such earnings are established.

Question 3. Whether Congress delegated, or under the Constitution could delegate, to the Commissioner, a discretionary power legislative in its nature, to determine what should constitute a "constructive average base period net income".

Question 4. Whether the computation of the constructive average is the statutory command which Congress has authorized to become operative upon the ascertainment of a basic conclusion of fact, namely the ascertainment of "a fair and just amount representing normal earnings".

Question 5. Whether the Commissioner's discretion ends with the determination of a fair and just amount representing normal earnings, and the remaining duty to compute the "constructive average base period net income" is only a purely ministerial duty.

Question 6. Whether the Commissioner in prescribing regulations which are contrary to the definition of "average base period net income" has exceeded his jurisdiction and attempted to exercise a pretended power beyond and outside of the limits fixed by statute for the exercise of the granted power.

Question 7. Whether regulations of the Commissioner are valid in providing that the "constructive average is a fair and just amount representing normal earnings" and that in computing the constructive average "a taxpayer is not entitled to use the rules provided by section 713(e) (1)".

Question 8. Whether the statutory authority to establish "a fair and just amount representing *normal earnings*" can be extended by the Commissioner to mean a fair and just amount representing a *constructive average*.

Question 9. Whether the Commissioner may deny the use of the 75% rule of section 713(e) in computing constructive average base period net income on the theory that the use of the 75% rule does not result in a fair and just amount.

Question 10. Whether the provisions of section 713(e) prevent the use of the formula prescribed by that section in determining the amount of the constructive average base period net income.

Question 11. Whether subsections (b) and (c) of section 722 in effect provide that a taxpayer is entitled to use section 713 after qualifying for relief, and if so whether the expression "constructive average base period net income" in section 722(a) should accordingly be construed with the definition of "average base period net income" in section 713.

Question 12. Whether the expression "constructive average base period net income" in subsection 722(a) is *in pari materia* with, and should be construed with, the definition of "average base period net income" in section 713.

Question 13. Whether the computation of the constructive average in the manner provided by section 713(e) as was clearly required by the 1941 enactment of section 722, was changed or intended to be changed by the language of section 722 as enacted in 1942.

Question 14. Whether the requirement of section 722(a) that the constructive average be used "in lieu of" the average determined under section 713(e) prevents the "constructive average base period net income" from being computed in the manner provided in section 713(e).

Question 15. Whether Regulations 112, Section 35.722-2 and other regulations which relate to the computation of



the constructive average, are invalid as a whole, or in part.

Question 16. Whether under the stipulation herein Stimson is entitled to have the figure for the year 1938 adjusted pursuant to the 75% rule of section 713(e) in using reconstructed 1937 earnings in the computation of the constructive average base period net income.

Question 17. Whether the expression "constructive average base period net income" should be construed so that section 722 might give the relief it was intended to provide.

#### **IV. Reasons for allowance of the writ.**

1. The Court of Appeals, in sustaining the Commissioner's assumption of power to determine the rules governing himself in the computation of the constructive average which rules have the effect of nullifying all or part of the excess profits tax relief to which thousands of taxpayers should be entitled after full compliance with all statutory requirements for obtaining such relief, has decided an important question relating to the construction of sections 713 and 722 of the Internal Revenue Code. Applications for such relief have been filed by approximately 17,600 corporations, and it is estimated that the total refunds of excess profits taxes to be claimed when all such applications shall have been filed will aggregate eight billion dollars.<sup>1</sup> Whether the Commissioner has the power thus to depart from the statutory definition of "average base period net income" in computing a "con-

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<sup>1</sup> Commissioner's Statement on the Administration of Section 722, for the Joint Committee on Internal Revenue Taxation, January 18, 1946, as reported by Commerce Clearing House, Volume 3A for 1946, paragraph 5607.05, page 9317.

structive average base period net income", has not been, but should be, settled by this Court.

2. The decision of the Court of Appeals, in sustaining the Commissioner's assumption of power to determine the rules governing himself in the computation of the constructive average and in holding (R. 72) that "'constructive average base period net income' is established by the discretionary use of rules and methods," is probably in conflict with principles of administrative law laid down and applied in the following:

*Addison v. Holly Hill Fruit Products, Inc.*, 1944,  
322 U. S. 607, 616, 88 L. ed. 1488, 1495.

*Waite v. Macy*, 1918, 246 U. S. 606, 608, 609, 62  
L. ed. 892, 894.

*Lukens Steel Co. v. Perkins*, 1939, Court of Ap-  
peals, Dist. of Col., 107 F. 2d 627, 630.

3. In treating the computation of the constructive average as though it were the ascertainment of a basic conclusion of fact by an administrative officer, rather than the statutory command which becomes operative when the Commissioner has determined as a basic conclusion of fact the "fair and just amount representing normal earnings to be used as" that average, the decision of the Court of Appeals is probably in conflict with the principles respecting the delegation of discretionary authority to administrative officers laid down by this Court in the following cases:

*Opp Cotton Mills v. Administrator*, 1941, 312 U. S.  
126, 145, 85 L. ed. 624, 636.

*Hirabayashi v. United States*, 1943, 320 U. S. 81,  
104, 87 L. ed. 1774, 1788.

*Yakus v. United States*, 1944, 321 U. S. 414, 424,  
425, 88 L. ed. 834, 848.

*Bowles v. Willingham*, 1944, 321 U. S. 503, 515,  
88 L. ed. 892, 903, 904.

4. In failing to hold that the computation of the constructive average is only a purely ministerial duty, the decision of the Court of Appeals is also probably in conflict with principles of administrative law laid down in the following:

*Roberts v. United States ex rel Valentine*, 1900,  
176 U. S. 219, 231, 44 L. ed. 443, 447.

*Butterworth v. Hoe*, 1884, 112 U. S. 50, 68, 28  
L. ed. 656, 662.

*Kendall v. Stokes*, 1838, 12 Peters (37 U. S.) 524,  
614, 9 L. ed. 1181, 1216.

*Müller v. Black*, 1888, 128 U. S. 40, 52, 32 L. ed.  
354, 358.

*United States v. Hines*, 1939, Court of Appeals,  
Dist. of Col., 103 F. 2d, 737, 745.

*Blair, Commissioner v. Birkenstock*, 1925, Court  
of Appeals, Dist. of Col., 6 F. 2d 679, 681.

*Blair, Commissioner v. Union Pac. R. Co.*, 1925,  
Court of Appeals, Dist. of Col., 6 F. 2d 484, 486.

5. In failing to hold that the relief provisions of section 722 should be construed to give the relief which Congress intended to provide, the decision of the Court of Appeals is probably in conflict with principles laid down and applied in the following:

*United States v. Ogilvie Hardware Co., Inc.*, April  
7, 1947, ..... U. S. ...., 47-1 U.S.T.C.,  
paragraph 9209.

*Bonwit Teller & Co. v. United States*, 1931, 283  
U. S. 258, 263, 75 L. ed. 1018, 1021.

6. Because of differences in language (R. 77), the Court of Appeals held that the 1942 Act did not provide

for computing the constructive average in the manner provided by section 713(e) as did the 1941 Act. In so holding the Court of Appeals disregarded the substance and effect of the 1942 Act as compared with the 1941 Act, and seems to have so far departed from the accepted and usual principles applicable to the construction of statutes (including the principle of resort to explanatory legislative history as laid down by this Court in *Harrison v. Northern Trust Co.*, 1943, 317 U. S. 476, 479, 87 L. ed. 407, 410) as to call for an exercise of this Court's power of supervision.<sup>5</sup>

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<sup>5</sup> See point B of argument in accompanying brief.

**Prayer for Writ.**

Wherefore, petitioner prays that this Court issue a Writ of Certiorari to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit in the instant case entered July 21, 1947, with respect to which a timely petition for rehearing was denied August 25, 1947.



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Of Counsel.

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1947.

No.  

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STIMSON MILL COMPANY,

*Petitioner.*

vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*  

---

**BRIEF IN SUPPORT OF PETITION FOR A  
WRIT OF CERTIORARI.**  

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**Opinions Below.**

The opinion of the Circuit Court of Appeals (July 21, 1947) is reported at ..... F. 2d ..... It is printed in full in the Transcript of the Record (at pages 62 to 80, inclusive).

The opinion of the Tax Court (October 31, 1946) is reported at 7 T. C. 1065. It is printed in full in the Transcript of the Record (at pages 21 to 40, inclusive).

**Jurisdiction.**

The grounds upon which the jurisdiction of this Court is invoked are stated under division II at pages 7 and 8 of the foregoing petition.

### **Statement of the Case.**

A statement of the case is set forth under division I at pages 1 to 7 of the preceding petition, and the same is hereby adopted and made a part of this brief.

### **Specification of Errors.**

Errors intended to be urged are those specified as questions 2 to 17, inclusive, under division III of the petition at pages 8 to 11, the Court of Appeals having ruled adversely to Stimson or having failed to rule on such questions.

### **Summary of Argument.**

A. Discretionary power of the Commissioner to determine "normal earnings" does not extend to prescribing rules for the computation of a constructive average base period net income differing from the applicable statutory definition. (Reasons 2, 3 and 4 for allowance of the writ.)

B. Provisions in the 1941 Act parallel to those in the 1942 Act require that the constructive average be computed in the manner provided by section 713, and such provisions were not changed in substance or effect by changes in language in the 1942 Act. (Reason 6 for allowance of the writ.)

C. Although Stimson's tax admittedly is excessive and discriminatory and although full proof has been made entitling Stimson to relief, nevertheless relief has been denied in disregard of principles of statutory construction laid down and applied by this Court in other cases. (Reason 5 for allowance of the writ.)

### Argument.

- A. Discretionary power of the Commissioner to determine "normal earnings," does not extend to prescribing rules for the computation of a constructive average base period net income differing from the applicable statutory definition.

The Commissioner has assumed power to prescribe that when section 722 is applied, the "*constructive*<sup>1</sup> average base period net income" shall be an ordinary arithmetic average instead of an "average base period net income" constructed by using normal earnings in the manner provided by section 713.<sup>2</sup>

It is submitted that the word, "constructive",<sup>3</sup> does not bestow such power on the Commissioner. While a "constructive" result is one that is built upon a certain assump-

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<sup>1</sup> Emphasis throughout this brief, by use of italics, is supplied by petitioner.

<sup>2</sup> Pertinent provisions of sections 713 and 722 and of the regulations are set forth in the appendix.

<sup>3</sup> Definition of "Constructive":

"Deduced by construction or interpretation; resulting from a certain interpretation; not directly expressed but inferred; inferential, virtual; often applied in legal language to what in the eye of the law amounts to the act or condition specified." A New English Dictionary on Historical Principles, by J. A. H. Murray, Vol. II, Part II, page 881, Oxford, 1893.

"Derived from, or depending on, construction or interpretation; not directly expressed, but inferred;—often applied in law to an act or condition assumed from other acts or conditions which are considered (either as an inference or from public policy) as amounting to or involving the act or condition assumed, as in **constructive** fraud, notice, total loss, trust, etc. \* \* \*"—Webster's New International Dictionary, Second Edition.

"That which amounts in the view of the law to an act, although the act itself is not necessarily really performed." Bouvier's Law Dictionary, 1897.

tion or assumptions, nevertheless, that result must have a close resemblance or similitude to the thing it represents by construction, so that in the view of the law it can reasonably amount to the thing itself which is thereby constructed.

*Constructive* receipt occurs where the assumed element is the clipping and cashing of coupons on bonds in the place of the actual element of clipping and cashing such coupons, and where the remaining actual elements — ownership of the bonds, maturity of the interest coupons, and ability of the issuer to pay — are the same as in actual receipt.<sup>4</sup> Similarly, a *constructive* “average base period net income” must be based on an assumed element which replaces an actual element and is combined with remaining actual elements in the formula for an “average base period net income.”

The statute does not leave to official discretion the assumption which is to be made for a “constructive average.” Section 722(a) specifies “a fair and just amount representing normal earnings to be used as a constructive average base period net income.” The Commissioner has discretion to determine “normal earnings.” But the constructive average is to be computed by using such “normal earnings” in the place of an actual element in the formula therefor. Since the formula of Section 713(e) provides for using “excess profits net income for each of the taxable years of the taxpayer in the base period,” it is obvious that “excess profits net income” is the element in the formula to be replaced by “normal earnings.”

Section 722(b) (1), here applicable, provides for relief

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<sup>4</sup> Merten's Law of Federal Income Taxation, Vol. 2, section 10.12, p. 19. See also *Id.*, Vol. 2, page 1, et seq., for other examples of constructive receipt.



from the effects of abnormalities "in one or more taxable years of the base period." Consequently, "normal earnings", established for Stimson for the year 1937, are to be substituted for "excess profits net income" for that year in the computation of the 75% rule, and the adjustment of the figure for 1938 to \$71,631.44 must follow as a matter of statutory requirement.

"When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." *Botany Worsted Mills v. United States*, 1928, 278 U. S. 282, 289, 73 L. ed. 379, 385.

Any alleged discretionary power of the Commissioner with respect to computing a constructive average, is bounded and limited by the specific statutory details outlined above, so that the Commissioner's action in prescribing contrary rules is a nullity — a mere attempted exercise of discretionary power beyond and outside of the statutory boundaries limiting his jurisdiction.

In sustaining the rent control provisions of the Emergency Price Control Act of 1942, this Court summarized the applicable administrative principles by stating:

"Congress here has specified the basic conclusions of fact upon the ascertainment of which by the administrator its statutory command is to become effective." *Bowles v. Willingham*, 1944, 321 U. S. 503, 515, 88 L. ed. 892, 903, 904.

The computation of the constructive average in the case at bar clearly appears to be — not "the ascertainment of a basic conclusion of fact" by the Commissioner, but — the statutory command which becomes effective upon the ascertainment of the fair and just amount representing normal earnings.

In holding invalid a regulation of the Administrator under the Fair Labor Standards Act, this Court reviewed

a situation which seems to be akin to that in the instant case, saying:

“In any event, Congress did not leave it to the Administrator to decide whether within geographic bounds defined by him the Act further permits discrimination between establishment and establishment based upon the number of employees. *The determination of the extent of authority given to a delegated agency by Congress is not left for the decision of him in whom authority is vested.* . . . The details with which the exemptions in this Act have been made preclude their enlargement by implication. . . . Construction is not legislation and must avoid ‘that retrospective expansion of meaning which properly deserves the stigma of judicial legislation.’” *Addison v. Holly Hill Fruit Products*, 1944, 322 U. S. 607, 616, 618, 88 L. ed. 1488, 1495, 1496.

For the reasons stated above it is respectfully submitted that the decision of the Court of Appeals is contrary to principles laid down and applied in decisions of this Court cited in reasons numbered 2, 3 and 4 in the Reasons For Allowance of the Writ set forth in the Petition.

**B. Provisions in the 1941 Act parallel to those in the 1942 Act, required that the constructive average be computed in the manner provided by section 713, and such provisions were not changed in substance or effect by changes in language in the 1942 Act.**

The Committee on Ways and Means in Report No. 2333 accompanying the Revenue Bill of 1942 reiterated the same purpose which had motivated Congress in providing for excess profits tax relief in the years 1940 and 1941. The report<sup>6</sup> states:

“The need for this legislation was recognized when

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<sup>6</sup> As reported in Internal Revenue Bulletin—Cumulative Bulletin 1942-2, at page 390.

the excess-profits tax was enacted in 1940, and in the excess-profits tax amendments of 1941, as pointed out in the committee reports on those Acts. . . . It was there stated that equitable considerations demand that every reasonable precaution should be taken to prevent unfair application of the excess-profits tax in abnormal cases; . . . The rates now proposed increase the need for expanding the application of the relief section to cases that do not fall under the specific provisions in order to remove inequities and alleviate certain hardships."

Since the same legislative purpose motivated the 1941 enactment of section 722 as motivated the 1942 enactment of that section, provisions of the 1941 Act may be considered in interpreting parallel provisions of the 1942 Act. The pertinent provisions of both Acts are shown in the appendix.

The 1941 Act (in section 722(b) (3)) specifically required that the constructive average be computed in the same manner as provided in section 713(d) which in turn requires use of subsections (e) and (f). In 1942 there was no need of referring specifically to the provisions of section 713(d) because the term "constructive average base period net income" includes the term "average base period net income" which is the title of the subject matter covered in section 713(d) and the designation of such title is itself a specific reference to section 713(d). Thus in both the 1941 Act and the 1942 Act the redetermined earnings for the years of the base period are substituted for "excess profits net income" in making the computation in the manner provided by section 713(d) — which in turn specifies the use of section 713(e) here applicable.

Contrary to the holding by the Court of Appeals (R. 77), in substance and effect the 1942 version of section 722 therefore did *not* omit the provision of the 1941 Act that

the constructive average be computed as in section 713. Similarly, the other of the changes in language in the 1942 Act cited by the Court of Appeals as "a drastic alteration of the law", namely that the 1942 Act "required a 'constructive average' to be used 'in lieu of' the section 713 average", is in fact no change whatever in substance and effect. Section 722(a) of the 1941 Act provided that "the amount established under paragraph (3) shall be considered as the average base period net income of the taxpayer for the purposes of this subchapter." By that language the 1941 Act requires exactly the same result as does the 1942 Act, namely that the constructive average (computed in the manner provided by section 713) be used in lieu of the section 713 average for the computation of the excess profits credit and the excess profits tax.

The Court of Appeals (R. 78) refused the aid of reports of Congressional committees which support the natural interpretation of the two Acts we have set forth above, and we submit that in so doing the Court of Appeals has held contrary to the principles laid down by this Court in *Harrison v. Northern Trust Co.*, 1943, 317 U. S. 476, 479, 87 L. ed. 407, 410, where this Court stated:

"But words are inexact tools at best and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how 'clear the words may appear on "superficial examination"'. *United States v. American Trucking Assn.*, 310 U. S. 534, 543, 544, 84 L. ed. 1345, 1350, 1351. See also *United States v. Dickerson*, 310 U. S. 554, 562, 84 L. ed. 1356, 1362."

It is submitted that the decision of the Court of Appeals disregards the substance of the 1942 Act as compared with the substance of the 1941 Act, and has so far departed from the accepted and usual principles applicable to the

construction of statutes as to call for an exercise of this Court's power of supervision.

C. Although Stimson's tax admittedly is excessive and discriminatory and although full proof has been made entitling Stimson to relief, nevertheless relief has been denied in disregard of principles of statutory construction laid down and applied by this Court in other cases.

In its opinion the Court of Appeals states (R. 78):

"Fourth: Taxpayer argues that since it has established both conditions precedent for the use of section 722, the tax must be determined by the constructive average. With this we agree."

The two conditions precedent for obtaining relief are:

1. That the tax is excessive and discriminatory.
2. What would be a fair and just amount representing normal earnings.

As a result of Stimson's proof of the effect of the strike on 1937 earnings, it follows under section 722(b) that the tax "shall be considered to be excessive and discriminatory" for the reason that Stimson's "average base period net income is an inadequate standard of normal earnings."

The average which Stimson has thus proven to be an inadequate standard is computed on the following elements required by the statute:

1. 1936 excess profits net income	\$ 89,422.67
2. 1937 excess profits net income	63,706.57
3. 1938—75% of average for other three years	66,242.25
4. 1939 excess profits net income	111,839.77

Inadequate average (without benefit of relief)	<u>\$ 82,802.82</u>
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Stimson also established that \$85,263.34 represented the corrected normal earnings for the year 1937. Both parties agree that such \$85,263.34 should replace the 1937 figure of \$63,706.57 in computing the constructive average.

They disagree, however, as to what should be done with the figure of \$66,242.25 for 1938. The Commissioner claims that this figure should be reduced to \$38,127.75, the "excess profits net income" for that year. Stimson claims the figure of \$66,242.25 should be increased to \$71,631.44 pursuant to the 75% rule after 1937 earnings are corrected.

Inasmuch as the above average has been proven to be inadequate, and inasmuch as the purpose of Congress in enacting this relief measure was clearly to make adequate such an inadequate average, it appears unreasonable, if not absurd, that the Commissioner should pretend to comply with the relief provisions by *reducing* a figure on which the average is computed. He might more plausibly contend that the 1938 figure should remain at \$66,242.25 in the constructive average. It is submitted, however, that section 722(a) clearly requires corrected "normal earnings" to be used in the manner provided by the formula of section 713(e), with a resulting figure of \$71,631.44 for 1938 and a constructive average amounting to \$89,539.31.

According to the Commissioner, the constructive average turns out to be less than the inadequate average of \$82,802.82 determined before relief was granted, with the result that relief must be denied. Stimson is left with the inadequate average of \$82,802.82 and the excessive and discriminatory tax based thereon. The relief provisions are thus interpreted as a futile Congressional gesture, and Stimson, having concededly complied with all statutory requirements to obtain relief, is nevertheless deprived of relief from a tax which section 722(b) declares to be excessive and discriminatory.

This Court has held that statutes should be construed to give the relief which Congress intended to provide. In *Bonwit Teller & Co. v. United States*, 1931, 283 U. S. 258, 263, 75 L. ed. 1018, 1021, this Court stated the principle involved:

“The section is a part of a tax law giving to taxpayers opportunity to secure a refund of overpayments that had become barred. Manifestly, it is to be construed liberally in favor of the taxpayers to give the relief it was intended to provide.”

This Court allowed the relief which Congress intended to provide in construing another relief amendment of the 1942 Act authorizing corporations to obtain refunds of undistributed profits tax, in *United States v. Ogilvie Hardware Co., Inc.*, ..... U. S. ...., decided April 7, 1947 (47-1 U.S.T.C., paragraph 9209), in which this Court said:

“The language of this extraordinary relief measure and the circumstances which prompted its passage convince us that Congress intended to provide refunds to corporate taxpayers. . . . In order that this purpose may be effected, the judgment of the Circuit Court of Appeals is affirmed.”

It is submitted that sections 713 and 722 not only can, but should, be construed to provide the relief intended, and that in failing to so construe these sections the decision of the Court of Appeals is in conflict with the principles laid down and applied in the cases just cited.

It is respectfully submitted that the prayer of the foregoing petition should be granted.



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## APPENDIX

### Excerpts from

Sections 712 and 713 of the Internal Revenue Code as amended<sup>1</sup> (Title 26, U.S.C.A., Sections 712 and 713).

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#### SUBCHAPTER E—EXCESS PROFITS TAX PART I

\* \* \* \* \*

#### §712. EXCESS PROFITS CREDIT—ALLOWANCE

(a) DOMESTIC CORPORATIONS.—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall, at the election of the taxpayer made in its return for such taxable year, be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed . . .

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#### §713. Excess profits credit—Based on income.

(a) Amount of excess profits credit. The excess profits credit for any taxable year, computed under this section, shall be—

(1) Domestic corporations. In the case of a domestic corporation—

(A) 95 per centum of the average base period net income,

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<sup>1</sup> Pursuant to Section 122(a) of the Revenue Act of 1945, the excess profits tax provisions of subchapter E of chapter 2 of the Internal Revenue Code "shall not apply to any taxable year beginning after December 31, 1945," 26 U.S.C.A. Internal Revenue Acts beginning 1940, p. 573.

(b) Base Period.

(1) Definition. As used in this section the term “base period”—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

• • • • •

(d) Average base period net income—determination.

(1) Definition. For the purposes of this section the average base period net income of the taxpayer shall be the amount determined under subsection (e), subject to the exception that if the aggregate excess profits net income for the last half of its base period, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (f), if greater than the amount determined under subsection (e).

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(e) Average base period net income—general average. The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other tax-

able years in the taxpayer's base period divided by the number of months in such other taxable years (herein called "average monthly amount") the amount used for such one year under this paragraph shall be 75 per centum of the average monthly amount multiplied by the number of months in such one year, and the year increased under this sentence shall be the year the increase in which will produce the highest average base period net income;

(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

(3) By multiplying the amount ascertained under paragraph (2) by twelve.<sup>2</sup>

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<sup>2</sup> Section 713(e)(1) was amended to the language above-quoted by section 215 of the Revenue Act of 1942, 26 U.S.C.A. Internal Revenue Acts beginning 1940, p. 292, effective for the year 1942. Previously section 713(e)(1) provided the "deficit rule" reading as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced, if for more than one of such taxable years there was a deficit in excess profits net income, by the sum of such deficits, excluding the greatest;

The deficit rule, just quoted, was provided by Section 4(a), Excess Profits Tax Amendments of 1941 (26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 79).

**Excerpts from  
Section 722 of the Internal Revenue Code (26 U.S.C.A.  
Sec. 722).<sup>3</sup>**

§722. General relief—Constructive average base period net income;

(a) *General rule.* In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard shall be had to the change in the character of the business under section 722 (b) (4) or the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

(b) Taxpayers using average earnings method. The tax

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<sup>3</sup> As amended by the Revenue Act of 1942, Section 222 (26 U.S.C.A. Internal Revenue Acts beginning 1940, pp. 297, 298, 299), effective for the year 1942, the year in question herein.

computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

. . . . .

**Excerpts from**  
**Section 722 (1941 Act) of the Internal Revenue Code as**  
**enacted by Section 6, Excess Profits Tax Amendments**  
**of 1941 (26 U.S.C.A. Internal Revenue Acts beginning**  
**1940, pp. 83, 84).**

**§722. ADJUSTMENT OF ABNORMAL BASE PERIOD NET INCOME**

(a) **GENERAL RULE.**—In the case of a taxpayer whose first taxable year under this subchapter begins in 1940, if the taxpayer establishes—

(1) that the character of the business engaged in by the taxpayer as of January 1, 1940, is different from the character of the business engaged in during one or more of the taxable years in its base period (as defined in section 713 (b) (1)); or

(2) that in one or more of the taxable years in such base period normal production, output, or operation was interrupted or diminished because of the occurrence of events abnormal in the case of such taxpayer; and

(3) the amount that would have been its average base period net income—

(A) if the character of the business as of January 1, 1940, had been the same during each of the taxable years of such base period; and

(B) if none of the abnormal events referred to in paragraph (2) had occurred; and

(C) if in each of such taxable years none of the items of gross income had been abnormally large, and none of the items of deductions had been abnormally small; and

(4) that the amount established under paragraph (3) is greater than the average base period net income computed under section 713 (d) or section 742, as the case may be,

then the amount established under paragraph (3) shall be considered as the average base period net income of the taxpayer for the purposes of this subchapter.

(b) RULES FOR APPLICATION OF SUBSECTION (a).

For the purposes of subsection (a)—

\* \* \* \* \*

(3) The average base period net income determined under subsection (a) (3) shall be computed in the same manner as provided in section 713 (d), except paragraphs (2) and (4), but for such purposes computing excess profits net income and deficit in excess profits net income on the basis of the assumptions made in subsection (a) (3).

(4) If subsection (a) (1), or both subsections (a) (1) and (a) (2) are applicable to any taxpayer, its average base period net income under subsection (a) (3) shall not exceed the excess profits net income (as computed for the purposes of subsection (a) (3), for the last taxable year in such base period. . . . .

**Excerpt from  
Regulations 112, Section 35.722-2(b).**

(1) Section 722(a) provides for the determination of a constructive average base period net income to be used in lieu of the actual average base period net income in those cases to which section 722 is applicable. Therefore, in computing such amount a taxpayer is not entitled to use the rules provided by section 713 (e) (1), relating to increase in base period net income of lowest year of base period, or by section 713 (f), relating to average base period net income in case of increased earnings in last half of base period. Since the constructive average base period net income is the fair and just amount representing normal earnings and will reflect adjustments for abnormally low base period years, a taxpayer having computed such amount is not entitled in addition to apply the rules provided by section 713(e) (1). In a proper case, however, growth may be recognized in arriving at the fair and just amount representing normal earnings if, and to the extent that, such recognition is reasonable and consistent with the conditions and limitations of section 722.